Life before Economic Regulation

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Conference on The Objectives of Economic Regulation
(Honouring the research of Prof Catherine Waddams)

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The Nationalised Industries

SCL personal recollections & publications but drawing heavily on
David Parker, *Official History of Privatisation* Vol 1

• 1945-51 Nationalisation of main industries
  – Guidance vague: “make available coal in qualities, quantities & prices as seem in public interest”
  – “break even taking one year with another”
  – No formal govt powers but much informal govt involvement

• Welfare economists urged marginal cost pricing

• With only limited questioning (on the fringe of economics?)
  – Coase 1946, Thirlby 1946, Wiseman 1953, 1957
Marginal cost pricing ascendant

- 1950s Growing concerns about performance & finance
- 1961 White Paper – introduced financial objectives
- But MC pricing seemed more interesting
  - 1964/5 Early SCL lecture to students: peak-load pricing electricity
- 1967 White Paper – economic performance targets, test discount rate, marginal cost pricing - official policy at last
  - Turvey 1968, 1971 applications in nationalised industries
  - SCL 1970 -77 mathematical programming & game theory to characterise MC pricing with joint costs, common costs, state-dependent costs, applied to US telecoms, Bham airport charges, weather-dependent water prices
  - Catherine Waddams 1973 thesis MC pricing in the gas industry
- Marginal cost pricing was what economists could contribute
In reality ....

• Did nationalised industries use MC pricing?
  – Mid-1970s SCL experience at Treasury/sponsorDept mtgs
  – 1976 NEDO report: No
  – Callaghan: “as Chancellor I couldn’t care less” (Crossman)

• Real problems: poor financial performance, inefficiency
  – Problem not that P≠MC, problem is that MC too high

• 1978 White Paper – confirm financial targets, required rate of return on new investment
  – And let industries work out their own prices

• But continuing deterioration in performance
  – Pryke 1981, 1982 deterioration due to poor mgt & govt policy
  – MMC 1980-3 reports “catalogue of deficiencies” (Parker)

• General feeling (Parker): “We cannot go on like this”

• Dennis Healey (1989): “Nationalisation has failed”
New economic thinking 1960s-1970s

- Austrian economics, competition as a rivalrous discovery process (Hayek via IEA, Kirzner)
- Public choice theory (Buchanan, Tullock)
- Agency theory, incentives, property rights (Manne, Alchian, de Alessi)
- Economics of regulation (Averch-Johnson, Stigler, Peltzmann, Demsetz)
- Monetarism/deregulation/free markets (Friedman)
- “Economic theory provided an important intellectual underpinning for privatisation” (Parker)
- YES, BUT this came a little later, because
  a) these were mostly US analyses, not then perceived as relevant to UK, and b) the UK political climate was adverse
UK Political climate 1950s-1970s

• 1950s-60s all-party acceptance of “mixed economy”
• 1968 Ridley (internal Conservative report): large scale denationalisation unrealistic
• 1970 Conservative manifesto (Heath): “stop further nationalisation”
  – 1972 U-turns: “lame ducks”, more intervention, prices & incomes policy
• 1979 Conservative manifesto (Thatcher): raise productivity in nationalised industries, clearer financial discipline, less government interference
• So nationalisation was seen as a problem ...
• But privatisation was not seen as the solution
• Hence no interest in economic regulation of privatised sector
  – “little appreciation that ‘de-nationalisation’ would involve anything very different from the reversal of previous nationalization policies” (Wiseman 1978)
The academic climate even harsher?

- **1955/7 Institute of Economic Affairs established**
  - “UK’s original free market think tank”
  - E.g. Wiseman “Growing without nationalisation” (1964)
  - “difficult to communicate antagonism to IEA” (Wiseman 1989)
  - “that Fascist lot” (“future Bank of England governor”)

- **1978 SCL Fallacy of Mixed Economy (IEA)**
  - “Austrian critique of economic thinking & policy”
    - Not just Austrian: public choice, property rights, econs of regulation
    - Discussed problems of nationalised industries, competition needed, but deliberately did not mention privatisation
    - Obvious solution, given experience & recent economic thinking
    - But to mention privatisation would be professional suicide
Unlocking the debate

- 1979 Mrs Thatcher elected PM – many difficult issues in this area
  - need to raise money, asset disposals, borrowing constraints on nationalised industries, increase nationalised industry prices, “wets v dries” struggle
- 1980-Jun 1981 Govt discussions of denationalisation – purely internal
- But some disposals were public – so some denationalisation was now Govt policy
  - So at last possible to discuss denationalisation publicly & professionally
- 1981 Oct SCL “10 Steps to Denationalisation” (J Econ Affairs)
  - “the real task is not to control the industries but to control government itself”
  - Restructuring, competition, initially privatise about half the nationalised sector
  - MMC reference after 5 yrs to assess situation. But no mention of regulation
  - Regulation was not the solution, it was the problem (US) and/or ineffective (UK)
- 1982 Oct CPRS study: How to increase competition by privatisation or other means
  - Privatisation, remove statutory barriers to entry, regulation “different from US but independent of Govt”, appeal to MMC, periodic reviews of rates of return, restructuring to enable competition & benchmarking, regional efficiency comparisons, “competition for the field”
  - Dept of Industry planning sale of British Telecom, had similar thinking on regulation
- Parker: CPRS Study impressive, predicted economic regulation in UK. But not public
  - available since 2012 at National Archives, Kew
Economic regulation goes public

• 1982 Nov Queens Speech: privatise BT + regulate it (Oftel)
  – 1982 extensive internal Govt debate on nature of this regulation
  – Dept proposal (MRR), Alan Walters’ objections (& ORPL)
• 1983 Feb SCL Report
  – Formally, decide between 2 schemes? Or 3rd? BUT it was more
• First public discussion of economic regulation in the UK
  – Attempt (with B) to provide crash course in relevant economics
    • Not marginal cost pricing, test discount rate, welfare econs etc
    • Austrian econs, pub choice, property rights, econs of regulation etc
  – Importance & feasibility of promoting competition in telecoms
  – Indicate potential case for ‘no explicit constraints’
  – Could be relevant if sufficient steps to increase competition?
  – Also attempt to position debate & policy for future privatisations
• 1983 Jun B&L Privatisation: Principles, Problems & Priorities
Economic regulation since 1983

• “Until SCL Report 1983, world of regulatory economics & policy [was] a small group clustered around discussion of US regulatory system and rate of return regulation ... since 1983 a closed world opened up” (Stern 2003 “What the Littlechild report actually said”)
• Kind, but several others c 1983 (Wiseman, CPRS, Walters, Beesley)
• Tho’ was there any discussion of economic regulation before 1983?
• Since 1983, many have analysed and developed economic regulation
  – Including a focus on how markets & regulation actually work
• Catherine Waddams a leader here:
  – productivity changes in gas & electricity, distributional effects, incumbent & entrant response, impact on fuel poor, do consumers switch to best supplier, measures of fuel poverty, impact of non-discrimination clauses, consumer response in regulated markets, consumer inertia in energy markets, collective switching, regulating residential energy markets, fairness in retail energy markets, etc etc
• A particular interest & achievement has been the analysis of fairness & equity
• This seems one of the main issues to grapple with going forward